

Follow-Up of the Audit of Utilities Department Construction Projects

**Report by the
Office of County Comptroller**

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August 20, 2014

Teresa Jacobs, County Mayor
And
Board of County Commissioners

We have conducted a follow-up of the Audit of Utilities Department Construction Projects (Report No. 383). Our original audit included the period of April 2002 to August 2006. Testing of the status of the previous Recommendations for Improvement was performed for the period July 2011 through December 2013. In addition, certain matters occurring outside the audit period were also reviewed.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The accompanying Follow-Up to Previous Recommendations for Improvement presents a summary of the previous conditions and the previous recommendations. Following each recommendation is a summary of the current status as determined in this review.

We appreciate the cooperation of the personnel of the Utilities Department and Procurement Division during the course of the audit.

Martha O. Haynie, CPA
County Comptroller

c: Ajit Lalchandani, County Administrator
Raymond Hanson, P.E., Director, Utilities Department
Ron Nielsen, Deputy Director, Utilities Department
Troy Layton, Manager, Field Services Division, Utilities Department
Johnny Richardson, Director, Procurement Division, Administrative
Services Department

**IMPLEMENTATION STATUS OF
PREVIOUS RECOMMENDATIONS
FOR IMPROVEMENT**

**FOLLOW-UP OF THE AUDIT OF UTILITIES DEPARTMENT CONSTRUCTION PROJECTS
STATUS OF PREVIOUS RECOMMENDATIONS FOR IMPROVEMENT**

NO.	PREVIOUS RECOMMENDATION	IMPLEMENTATION STATUS			
		IMPLEMENTED	PARTIALLY IMPLEMENTED	NOT IMPLEMENTED	NOT APPLICABLE
1.	We recommend the County ensures future construction contracts include a "VE" clause in the basic contract in a prominent location. Further, contractors should be encouraged to suggest such changes.	✓			
2.	We recommend the County considers modifying the direct purchasing clause to encourage its use on a case-by-case basis, in order to consider the nature and extent of materials included in the contract, regardless of the total project cost.	✓			
3.	We recommend Utilities periodically compares the labor rates and hours worked as shown on invoices to supporting payroll documentation from the consultant for not-to-exceed contracts. This review should be performed at least once per contract period.			✓	
4.	We recommend Utilities ensures contractor invoices provide the details, as required by the contracts, relative to the specific tasks performed during a billing period.		✓		
5.	We recommend the following:				
A)	Utilities ensures that complete documentation supporting all the various elements of costs are included with future proposals for changed work; and		✓		

**FOLLOW-UP OF THE AUDIT OF UTILITIES DEPARTMENT CONSTRUCTION PROJECTS
STATUS OF PREVIOUS RECOMMENDATIONS FOR IMPROVEMENT**

NO.	PREVIOUS RECOMMENDATION	IMPLEMENTATION STATUS			
		IMPLEMENTED	PARTIALLY IMPLEMENTED	NOT IMPLEMENTED	NOT APPLICABLE
5. B)	The Procurement Division considers implementing a procedure requiring the person responsible for negotiating the price of a change order, greater than a specified amount, to prepare a "Memorandum of Negotiations." This memorandum would include the original proposed amount and the details of adjustments made to the proposal as a result of the review and negotiations.	✓			
6.	We recommend the Procurement Division revises the Purchasing Manual to include guidance on limiting the expected length of time that task authorizations may exceed the term of the contract before requiring Board approval.	✓			

INTRODUCTION

Scope and Methodology

We have conducted a follow-up of the Audit of the Utilities Department Construction Projects (Report No. 383). Our original audit included the period of April 2002 to August 2006. Testing of the status of the previous Recommendations for Improvement was performed for the period July 2011 through December 2013. In addition, certain matters occurring outside the audit period were also reviewed.

We interviewed personnel with the Utilities Department and Procurement Division. We also reviewed source documents and performed the tests necessary to determine the implementation status of the previous recommendations. We have described the specific methodologies utilized during our review in the implementation status of each Recommendation in the Follow-up to Previous Recommendations for Improvement section of this report.

**FOLLOW-UP TO PREVIOUS
RECOMMENDATIONS FOR
IMPROVEMENT**



1. Construction Contracts Should Include a Clause to Encourage Contractor Initiated Value Engineering Change Orders

Value Engineering (VE) is a process whereby savings can be obtained when a contractor makes a suggestion to substitute materials that are different and less costly than what was originally specified. Our prior review of two construction contracts revealed that there was not a specific “Value Engineering” section. Instead, Article 9 of the General Conditions, in both contracts, titled, “Contractor’s Responsibilities” contained a sub-clause called “Substitution of Materials.” In this Section, it stated that if the contractor substituted lower cost materials for those specified, the savings would be shared between the contractor and the County in accordance with the instructions to the bidders (which stated the savings would be shared equally).

Including this language in the sections of the contracts as described above neither emphasized the importance of VE nor sufficiently encouraged contractors to seek out opportunities for VE changes.

We Recommend the County ensures future construction contracts include a “VE” clause in the basic contract in a prominent location. Further, contractors should be encouraged to suggest such changes.

Status:

Implemented. We reviewed two contracts (Y11-768-PH and Y12-743-PH) and noted that VE is prominently located in Article 26 of the General Conditions. In addition, Section B. – Subcontractors, encourages Contractors to include VE provisions in contracts with subcontractors. Specifically, Section B. states:

“The contractor is encouraged to include the provisions of this Section in contracts with subcontractors. The contractor shall encourage submission of Value Engineering Change Proposals

(VECPs) from subcontractors, however, it is not mandatory that VECPs be submitted nor is it mandatory that the contractor accept or transmit to the County VECPs proposed by his subcontractors.”

2. The County Should Consider Expanding Its Use of the Direct Purchasing Method of Procurement to Achieve Further Sales Tax Savings

During our prior audit, we noted that the County did not purchase any materials or equipment directly from suppliers to take advantage of the County tax exempt status (referred to as direct purchases) for the two construction contracts reviewed. In addition, we noted that the County had previously implemented a policy whereby all construction contracts in excess of \$10 million would only be considered for direct purchases. The initial costs of the two construction contracts reviewed were \$7.9 million (Y5-700-PH) and \$7.8 million (Y3-754-PH), respectively. As such, neither of these projects were considered for direct purchases.

There are times when a project costing less than \$10 million may provide opportunities for significant savings. In this regard, the prior audit identified a number of examples of high priced items for both contracts reviewed where, if they had been purchased directly by the County and furnished to the contractors, sales tax in excess of \$76,000 would have been saved.

We Recommend the County considers modifying the direct purchasing clause to encourage its use on a case-by-case basis, in order to consider the nature and extent of materials included in the contract, regardless of the total project cost.

Status:

Implemented. Our review of two contracts (Y11-768-PH and Y12-743-PH) revealed that the language of Article 24 of the General Conditions was revised to include the use of direct

purchases for contracts valued at less than \$10 million. Specifically, Article 24 includes the following:

For construction contracts valued at \$10,000,000 or lesser amounts as determined by the County, the County may, at its discretion, use the direct purchase method for large dollar value equipment and materials. Direct purchases will be negotiated with the contractor based on those items identified by the professional.

Because our recommendation was limited to contract language only, testing did not include examining the specific contracts for direct purchase utilization.

3. Invoices for Fee Not-to-Exceed Contracts Should Be Reviewed to Ensure Accuracy and Conformance with Contract Terms and Conditions

During the prior audit, we noted that the County entered into a contract with a consultant to provide construction program management services. Paragraph 4.1, required that compensation performed under the fee not-to-exceed method would be the consultant's actual direct salary times a multiplier of 2.99 plus sub-consultants' costs and other direct costs. The contract also included a schedule detailing the maximum hourly rates applicable to classifications of personnel likely to be employed to perform the services.

During our prior review of a sample of invoices, we noted the following:

- A) Each invoice included a list of position titles, salary rates, and labor hours, purported to be those that were actually incurred. However, the position titles and rates did not always conform to those listed in the contract.
- B) Utilities personnel did not ask the consultant to provide supporting documentation for actual labor rates or hours worked, for review.

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Without reviewing the consultants support for hours worked and rates paid by the County, in effect, Utilities personnel treated the purchase order as if it were a lump sum. This negated the purpose of using the fee not-to-exceed method of procurement (which provides for the opportunity for a lower actual cost of services). By not ensuring that salary rates listed in invoices were in accord with rates shown on actual payroll documentation, Utilities had no assurance that it was paying the correct amounts.

We Recommend Utilities periodically compares the labor rates and hours worked as shown on invoices to supporting payroll documentation from the consultant for not-to-exceed contracts. This review should be performed at least once per contract period.

Status:

Not Implemented. Interviews with personnel from the Engineering and Fiscal and Operational Support Divisions revealed that an adequate review of the invoiced rates of pay and hours worked is not performed. Engineering personnel only review the positions, rates of pay, and hours worked shown on invoices for reasonableness based on professional experience. Fiscal and Operational Support personnel compare the rates included in the initial invoice with the rates included in the contract; however, no supporting documentation is reviewed.

We Again Recommend Utilities periodically compares the labor rates and hours worked as shown on invoices to supporting payroll documentation from the consultant for not-to-exceed contracts. This review should be performed at least once per contract period.

Management's Response:

We Concur. The Utilities Department made initial efforts to set up this process when the construction project audit was originally concluded. However, during the recent follow-up



audit, it became apparent that the process was not fully implemented and maintained to the present day. Since becoming aware of this, Utilities management has renewed the effort to formalize and implement the process. To that end, a new procedure has been written and communicated to staff, an audit status tracking mechanism for contracts that fall into this category has been put in place, and a single point of responsibility for this process has been established.

Since taking these steps, staff has identified twelve (12) contracts that should be subject to this payroll audit, and the respective vendors have been contacted to provide payroll information. At this point, we've received this information from five (5) of the vendors and one of the audits is near completion.

4. Invoices Relative to Lump Sum Consulting Contracts Should Include Required Detailed Information as to the Services Provided

During the prior audit, we noted that invoices submitted by the consultant providing engineering services during the design and construction phases for improvements to the master pump stations did not contain a sufficient level of detail to determine the services that were actually performed during the billing period. The invoices only contain the total funds allocated to the pump, the percent complete, the amount billed to date, the amount previously invoiced, and the amount due for the current billing period.

We Recommend Utilities ensures contractor invoices provide the details, as required by the contracts, relative to the specific tasks performed during a billing period.

Status:

Partially Implemented. We reviewed the support documentation for six invoices associated with two Professional Engineering Consulting Services contracts (Y4-809 and Y6-809) and noted that two of the invoices did not

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include sufficient details regarding the tasks performed. The two invoices (No. 1123927 for \$76,902.00 and No. 1146260 for \$76,359.82) were associated with contract Y6-809.

Contract Y6-809, II. Payment, B. Progress Payments, includes the following:

All requests for payment must be accompanied by a narrative description of the scope of services from Exhibit A performed by the consultant and sub-consultants during the period covered by the invoice. The narrative shall also describe the work to be performed during the next billing period.

The support documentation for both invoices included sub-consultant invoices that only contained the total funds allocated to the project, the percent complete, the amount previously invoiced, and the amount due for the current billing period.

We Again Recommend Utilities ensures contractor invoices provide the details, as required by the contracts, relative to the specific tasks performed during a billing period.

Management's Response:

We concur. Under our current procedure, the project managers and their supervisors are required to review and approve invoices prior to payment. The invoices are required to include enough detail information for them to approve the requested amount. Sometimes, project managers that are intimately familiar with the project may have overlooked the amount of details included with invoices yet approve the invoice based on their personal knowledge of progress with the project. Moving forward, both the project manager and their supervisors will be stricter with the requirement of including details on the specific tasks performed during the billing period.



5. Utilities Should Ensure That Proposed Prices for Change Orders Are Fully Supported and Details of Negotiations Are Documented in a Memorandum

During the prior audit, we noted that one of the change orders for the pump station project was not adequately supported. The change was issued for \$109,804 to cover repairs to a "30 inch Depend-O-Lok." Support was lacking as follows:

- Fringe benefits of \$11,383 were based on 67.5 percent being applied to direct labor costs. No support for these benefits was provided until requested by the auditors after the change order had been issued and approved.
- A daily rate of \$500 (for one day) for a Project Manager was included in the proposal equating to an hourly rate of \$62.50. The hourly rate for the Project Manager shown in the fringe benefits details, provided after the change order was issued, was \$55 per hour. No payroll documentation was submitted to determine which rate was correct.
- A daily rate of \$400 (for 10 days totaling \$4,000) for a Project Superintendent was included in the proposal equating to an hourly rate of \$50. The hourly rate for the Project Superintendent shown in the fringe benefits details was \$35. No payroll documentation was submitted to determine which rate was correct.
- The amount of overhead included in the proposal was incorrectly calculated at \$5,412. In the proposal, it was shown as five percent of line 30. However, line 30 included the contractor's cost, the sub-contractor's cost, and overhead. The five percent should only have been applied to the total of the contractor's and the sub-contractor's costs for total overhead of \$4,464 or \$948 less than the proposed amount.

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We Recommend the following:

- A) Utilities ensures that complete documentation supporting all the various elements of costs are included with future proposals for changed work; and,
- B) The Procurement Division considers implementing a procedure requiring the person responsible for negotiating the price of a change order, greater than a specified amount, to prepare a “Memorandum of Negotiations.” This memorandum would include the original proposed amount and the details of adjustments made to the proposal as a result of the review and negotiations.

Status:

- A) Partially Implemented. We reviewed the three change orders (noted in the table below) that were issued during the audit period that required Board approval and noted that sufficient documentation was not maintained with the contract file or change order for one of the three change orders.

Contract No.	Project	Change Order Increase Amount	Sufficient Pricing Support Maintained
Y11-731	Lake Lawn Gravity Sewer Improvements	\$181,290	No
Y11-731	Lake Lawn Gravity Sewer Improvements	\$110,208	Yes
Y12-709	Shingle Creek Transmission Force Main & Reclaimed Water Main - Phase 1	\$318,903	Yes

Although documentation to support the change order pricing was subsequently provided for the one noted through additional inquiries and sources, it was not sufficient to adequately support the change order pricing when the change order was approved.



We Again Recommend Utilities ensures that complete documentation supporting all the various elements of costs are included with future proposals for changed work.

Management's Response:

We concur. The documentation for the negotiation of the change order Y11-731 is in the project file and provided at the time of the audit however, it was not attached nor readily accessible at the time the change order was processed.

Currently, the Memorandum of Negotiation letter is prepared for change order items added to the contract and the supporting documentation is attached to justify the pricing of the work and provide evaluation and negotiation of the line item costs to ensure complete documentation. We will ensure consistency in this practice.

- B) Implemented. We reviewed the Orange County Purchasing Procedures Manual and noted that the manual was revised to include the requirement that a Price Negotiation Memorandum (PNM) be completed for all sole source contracts valued at \$100,000 or greater and for change orders / amendments to existing contracts that require Board approval. A review of the PNM revealed that the proper completion of the form would include the relative components of negotiation, including the original proposed amount and the details of adjustments made to the proposal as a result of negotiations. In addition, we noted that the Manager of the Procurement Division advised County Department and Division Managers of the revision in March of 2007.

6. Purchase Orders Should Not Include a Scope of Work That Is Expected to Be On-going Far Beyond the Expiration of the Applicable Contract

During the prior audit, we noted that a purchase order was issued and later amended to a total of \$677,735 approximately one-year from the end of the five-year contract term (3 years plus two one-year renewals). It was anticipated by all parties that this service would need to be performed over the three-year life of the project. Thus, the Purchase Order extended the original contract to a period of over 7 years.

The County's policy during the audit allowed for the issuance of task authorizations that exceeded the contract term. This wording was as follows:

"Any Purchase Orders for Task authorizations issued during the effective period of this contract and not completed within that period shall be completed by the consultant within the time frame specified in the Purchase Order. The contract shall govern the Consultant's and the County's rights and obligations with respect to that order to the same extent as if the order was completed during the contract's effective period."

No guidance was given as to how far beyond the term of the contract a task authorization could cover.

Although the above term extension did not violate any regulations regarding County procurement; it conflicts with the spirit of competition as it allowed a contractor to provide services in excess of the original anticipated contractual period. This process seemed to counter the objectives of the County's Procurement policy of dealing fairly with all vendors wishing to do business with Orange County and maximizing competition for all procurement. This practice could also have impaired the County from receiving these services at the most competitive price.

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We Recommend the Procurement Division revises the Purchasing Manual to include guidance on limiting the expected length of time that task authorizations may exceed the term of the contract before requiring Board approval.

Status:

Implemented. Although the Purchasing Procedures Manual was not revised, the Procurement Division Manager stated that contracts would be monitored to ensure task authorizations with an extended performance time are not issued in the last few months of the contract. As part of our testing, we inquired as to the current procedures used for monitoring by the Division. The Division provided minutes of a staff meeting where the monitoring of task authorizations in the last few months of a contract period was discussed after the prior audit. Further, we were provided an e-mail evidencing a situation that indicated the monitoring had taken place on a specific expiring contract. As such, we consider the steps taken to be sufficient in the circumstances and will consider a future review of the procedures County-wide.